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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1945.

No. 117

IN THE MATTER OF
PEER MANOR BUILDING CORPORATION,
Debtor.

W. D. WITTER AND JOSEPH WILLENS,
Petitioners.

vs.

G. J. NIKOLAS, ET AL.,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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Dated: May 20, 1946.

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PETITION FOR WRIT OF CERTIORARI.

Petitioners W. D. Witter and Joseph Willens jointly and severally petition that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit of March 13, 1945, affirming the decision below approving the petition for involuntary reorganization of the debtor as filed in good faith and appointing a trustee for the estate of the debtor and denying a rehearing.

STATEMENT OF THE MATTER INVOLVED.

Three creditors invoked the jurisdiction of the Bankruptcy Court to obtain a reorganization of the Peer Manor Building Corporation under Chapter X. Their first petition alleged that the debtor was a corporation and after they obtained the approval of the petition, the order was reversed on the ground that the corporation was dissolved more than two years prior to the filing of the petition and that such a corporation was neither a *de facto* nor a *de jure* corporation and could not be reorganized under Chapter X (134 F. (2) 839). Certiorari was denied here (320 U. S. 211). Thereafter, on July 8, 1943, the same creditors filed a second petition (R. 2-10)* alleging that the Peer Manor Building Corporation could be reorganized as an "unincorporated company." The petition alleged that the petitioners "had formulated" a plan under which the property would be acquired for the first mortgage bondholders as there was no equity for the creditors and stockholders. The District Court held that the former adjudication was binding upon it and dismissed the proceedings for want of jurisdiction on September 13, 1943 (R. 64).

In the absence of a restraining order during the pendency of the petition and with no supersedeas during the pendency of the appeal, Witter completed a partial foreclosure in the State Court which was pending two years prior to the filing of the involuntary petition in bankruptcy. He obtained title through the foreclosure proceedings on February 6, 1944, while the bankruptcy proceeding stood as dismissed. Thereafter, petitioner Joseph Willens acquired the title on October 24, 1944 (Tr. 53).

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* The letter "R" refers to the record in Case 8472 (324 U. S. 757 No. 404), which record is part of the record in this case (Tr. 39).

On November 2, 1944, the mandate of the Court of Appeals reversing the dismissal order was filed (Tr. 22). Witter then obtained leave to file an answer contesting the good faith of the petition, which answer was filed on November 20, 1944 (Tr. 5). Without any evidence tending to support the jurisdictional requirements as to "good faith", the District Court approved the petition as filed in good faith (Tr. 22) and referred the matter to a Master in Chancery to hear evidence on the Plan of Reorganization with the understanding that the Court would reconsider the question of good faith upon the coming in of the report on the plan. It entered its order approving the petition as filed in good faith and appointing a trustee on March 13, 1945, (Tr. 22) and on April 10, 1945, Witter appealed (Tr. 31).

During the pendency of the appeal the Master in Chancery rendered his report recommending the vacation of the order approving the proceedings as filed in good faith and the dismissal of the proceedings on the ground that the evidence showed that the "unincorporated company" was nonexistent; further that all of its interest was divested by the completion of the foreclosure proceeding and that title was vested in Joseph Willens prior to the approval of the petition; that he was not made a party to the proceedings; that no reorganization proceedings may be invoked under Chapter X for liquidation purposes, and that at the time of the filing of the petition there was no prospect of rehabilitation of the debtor and there is not now such a prospect (Tr. 45-46). A motion was made in the Court of Appeals to postpone the hearing on the appeal pending the disposition of the hearing on the Master's report which motion was taken under advisement.

The Circuit Court of Appeals refused to postpone the hearing on the appeal pending the disposition of the case

on the Master's report involving the merits, and affirmed the order below. When its attention was called, on rehearing, that certain exhibits were in the record (which it stated in its opinion that due to the nonproduction of such exhibits it had to assume that the order was properly entered on these exhibits and it, therefore, had to affirm the order), it modified its opinion and stated that it examined the exhibits and they substantiate the order. It did not point out, however, how these exhibits tended to substantiate the order or its opinion.

THE QUESTIONS PRESENTED.

The following questions are presented for the consideration of the Court:

1. Whether a petition for corporate reorganization under Chapter X, where liquidation and not a readjustment of the rights of creditors was at the very outset the only possibility, which was assailed as to its good faith by the answer of a creditor, was properly approved as filed in good faith, and whether the opinion affirming the approval is in harmony with the views of this Court as interpreted by other circuits.

2. Whether it was proper to approve an involuntary petition as filed in good faith in the face of the answer contesting the good faith, without requiring the petitioners to prove the specific facts as required in Sections 130, 131 and 146 of Chapter X.

3. Whether an involuntary petition for corporate organization under Chapter X was properly approved as filed in good faith when it appeared that the assets of the debtor were substantially less than the amount due on the first mortgage bond issue and no conceivable plan could be adopted whereby equity owners and other creditors

could participate in the reorganization and there was pending a foreclosure proceeding in the State Court for the benefit of the first mortgage bondholders and in the absence of a showing that this proceeding was inadequate to grant the relief.

4. Whether the Circuit Court of Appeals was warranted in refusing to postpone the hearing on the appeal from the order approving the petition as filed in good faith when the District Court in entering the order referred the Plan of Reorganization to a Master in Chancery and stated that it would reconsider the question of good faith upon the coming in of the report, and when the Master's report recommended the vacation of the order approving the petition as filed in good faith and the dismissal of the proceedings on the ground that the unincorporated company was nonexistent, that its title was divested by foreclosure, and that a stranger to the reorganization proceedings had obtained title who was not a party to the proceedings.

5. Whether a prior foreclosure proceeding which was not restrained by the Bankruptcy Court in a subsequent reorganization proceeding under Chapter X, and which was completed after the dismissal of the reorganization proceedings for want of jurisdiction, while an appeal was pending which did not operate as a supersedeas, extinguished the interest of the debtor so that there was no property to reorganize after the reversal of the dismissal order, as contended by the petitioners, or whether the foreclosure proceeding was void and the title acquired thereunder was of no effect, as held in the instant case.

REASONS FOR THE GRANTING OF THE WRIT.

1. The decision, that upon a contest on the good faith of an involuntary petition for corporate reorganization

under Chapter X, an order approving it was proper when it appeared that the liability on the first mortgage bond issue exceeded the assets and that under no conceivable theory was there anything for creditors or stockholders to participate in the reorganization, is in direct conflict with the decision of other Circuits and with decisions of this Court*.

2. The decision, that in the absence of a restraining order in a Chapter X proceeding which was dismissed for want of jurisdiction and from which dismissal order an appeal was taken without a supersedeas, the State court was without power to complete the foreclosure before the reversal of the dismissal order on appeal, and that an involuntary petition for reorganization was properly approved as filed in good faith when prior to its approval the title of the alleged unincorporated company was divested, is in conflict with the fundamental law of bankruptcy.

3. There is a disagreement between the Second, Third, Fourth and Sixth Circuits and the Seventh Circuit Court of Appeals on the interpretation of the decisions of this Court that a petition for corporate reorganization should not be approved as filed in good faith when it appeared that the assets were less than the first mortgage indebtedness and there is nothing for stockholders and creditors to receive under any conceivable plan**.

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* Fidelity Assurance Association v. Sims, 318 U. S. 608; Marine Harbor Properties v. Manufacturers Trust Co., 317 U. S. 88; In Re: Loewer's Gambrinus Brewery Co., 141 F. (2) 747, 749; Country Life Apartments v. Buckley, 145 F. (2) 935, 938; Patent Cereal v. Flynn, 149 F. (2) 711, 713; Lorraine Castle Apartment Building Co., 149 F. (2) 55.

** Compare Biltmore Apartments Building Trust, 146 F. (2) 81, C.C. A. 7, with St. Charles Hotel Co., 149 F. (2) 645, C.C.A. 3.

4. The approval of the petition as filed in good faith was without evidence, notwithstanding the answer contesting its good faith. The District Court stated that it would reconsider the matter after the Master had rendered his report on the Plan of Reorganization. The Master rendered his report after hearing evidence on the merits and concluded that the unincorporated company was nonexistent; that it was divested of all title and that under the plan no participation could be given to creditors or stockholders. He recommended that the order approving the petition as filed in good faith be vacated and the proceedings be dismissed. His recommendation was also based on the fact that petitioner Joseph Willens, not a party to the proceeding, acquired the title to the premises through the foreclosure sale while no bankruptcy proceeding was pending and the appeal did not operate as a supersedeas. These facts were brought to the attention of the Court of Appeals which was asked to postpone the hearing on the appeal pending the disposition of the case on the Master's report. The Court of Appeals took the matter under advisement but rendered its decision sustaining the order below in disregard of the Master's report. A denial of certiorari would compel petitioner Willens to go through with the proceedings before the District Court on the Master's report and thereafter appeal to the Circuit Court of Appeals followed by another application for a writ of certiorari.* Such a procedure would be burdensome on all parties, and in the interest of justice and expedience, the writ should be issued, so that all questions could be settled and circuity of appeals be avoided.

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* The District Court after the rendition of the opinion stated that while in the absence of the opinion it would have sustained the Master, in the face of the opinion it would be compelled to overrule his report unless certiorari was granted and the opinion was reversed. The hearing on the report was continued until the disposition of this petition.

3. The Circuit Court of Appeals has decided important questions in the field of bankruptcy which, if permitted to stand, will cause much confusion. The questions concerned are of public interest and its decision is in conflict with decisions of other circuits and is based on a misinterpretation of the decisions of this Court. The writ should be issued to clarify the law and to settle the administration and reorganization proceedings under Chapter X.

PRAYER FOR RELIEF.

Wherefore, petitioners, jointly and severally pray that this petition for a writ of certiorari may be granted and that this Court proceed as provided by law and the rules of this Court in such cases, and that upon final hearing, the judgment of the United States Circuit Court of Appeals for the Seventh Circuit be reversed.

Respectfully submitted,

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BRIEF IN SUPPORT OF PETITION.

Jurisdiction Invoked.

The decision of the Circuit Court of Appeals sustaining the order below was rendered on February 12, 1946. A rehearing was denied on March 9, 1946, and the petition is therefore filed timely and the jurisdiction of this Court is invoked under Judicial Code Section 240 (a), 28 USCA Section 347 (a) as amended by the Act of February 13, 1925.

Opinion Below.

The opinion of the Circuit Court of Appeals appears in this record (Tr. 59-65). The ruling on the rehearing also appears in this record (Tr. 95). The opinion is published (153 F. (2) 802).

A Statement of the Case.

History of the Proceedings: After the adjudication that the Peer Manor Building Corporation was neither a *de jure* nor *de facto* corporation because of its dissolution more than two years prior to the filing of the reorganization proceedings (134 F. (2) 839, certiorari denied 320 U. S. 211), the same creditors filed a second involuntary petition on July 8, 1943, for corporate reorganization on the ground that the alleged corporation was an "unincorporated company" (Tr. 49). The District Court dismissed the proceedings for want of jurisdiction because of the former adjudication. Petitioner Witter completed the foreclosure of the property during the pendency of the appeal from the dismissal order, which appeal did not operate as supersedeas, and without a restraining order. After he obtained title, the dismissal order was reversed (143 F. (2) 764) and he became the owner through a

Commissioner's Deed. Petitioner, Joseph Willens, who was not a party to the proceeding below, became the grantee of the property on October 27, 1944 (Tr. 53) so that the title of the debtor was completely extinguished by the partial foreclosure, subject to the continuing lien of the remainder of the bond issue, when the mandate was filed on November 2, 1944.

Upon the filing of the mandate Witter obtained leave of court to file an answer contesting the good faith of the petition (Tr. 11-12). His answer, filed on November 20, 1944, stated, among other things, that the alleged "unincorporated company" had no property to be reorganized because of the foreclosure, decree, sale and conveyance (Tr. 5-10). On March 13, 1945, the District Court approved the petition as filed in good faith and appointed a trustee (Tr. 22-28) from which order Witter prosecuted an appeal on April 10, 1945 (Tr. 31).

During the pendency of the appeal the petitioning creditors (the respondents) obtained a reference to a Special Master on their Plan of Reorganization. Witter moved to stay the proceedings pending the disposition of his appeal, which stay was opposed by the respondents. The matter was heard by the Special Master, who rendered his report on January 3, 1946 (Tr. 47) finding that the title of the debtor was extinguished by foreclosure and the title was vested in Joseph Willens, who was not a party to the proceedings. The Master recommended the dismissal of the involuntary proceedings (Tr. 56). The hearing on his report was set before the District Court for March 15, 1946 (Tr. 45) and on January 26, 1946, Witter moved to postpone the hearing on the appeal pending the disposition on the merits on the Master's report (Tr. 44). The Circuit Court of Appeals took Witter's motion under advisement upon the oral argument (Tr. 58), and rendered its opinion on February 12, 1946, sus-

taining the order below (Tr. 59-65). Witter filed a petition for rehearing wherein he urged that the Court of Appeals overlooked that the exhibits, which it stated in its opinion were not before it and on which it assumed that they were the basis for order were, in fact, in the record (Tr. 70-76). The Court of Appeals conceded its error but stated that it thereafter examined the exhibits and that they substantiated the finding below (Tr. 95).

The Involuntary Petition: The involuntary petition for reorganization was filed on July 8, 1943 (R. 2).* It alleged that petitioners were creditors of the Peer Manor Building Corporation, an "unincorporated company". Its assets consisted of a six-story apartment building and furniture, fixtures and personal property located therein, and a claim for $20,000.00 against Peer, the former owner, besides cash in the sum of $681.34. Its liabilities consisted of $154,000.00 in first mortgage bonds described in a Trust Deed to Heitman Trust Company as trustee together with defaulted interest since November 28, 1941, current accounts payable, a claim of the Internal Revenue, and unpaid taxes to the State of Illinois. There were then pending in the State court the partial foreclosure of Witter and a complete foreclosure of the Heitman Trust Company. Petitioners alleged that they had formulated a Plan of Reorganization whereby a newly formed corporation would acquire the property and would issue its common stock in exchange for the first mortgage bonds. None of the stockholders and other creditors were to participate in the reorganization as there was no value in assets above the first mortgage bond issue.

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*The petition for reorganization is contained in the transcript in Case No. 8472 which was made a part of this record by reference (Tr. 2, 39). This record is on file in this court (323 U. S. 757 No. 404), and will be referred to by the letter "R". The reference to the printed record in this case is by the letters "Tr."

The Good Faith: The answer of Witter contesting the good faith of the petition (Tr. 5), after denying the allegations of the petition that the Peer Manor Building Corporation was an "unincorporated company", stated that since February 6, 1944, the property described in the petition was not owned by the debtor. Since no restraining order was ever issued in the proceedings while they were pending, and the reorganization proceeding was dismissed by the District Court for want of jurisdiction, he prosecuted to a decree and sale the pending partial foreclosure and acquired the title by a deed of conveyance upon the failure of the debtor to redeem, and the alleged "unincorporated company" was left without any property to be reorganized. The "good faith" was also challenged on the ground there was pending the prior first mortgage foreclosure and that the interest of the bondholders would be best served in that proceeding. Petitioning creditors were seeking to eliminate the interest of the equity owners and all other junior creditors and the proposed plan was to liquidate the debtor for the benefit of the Peer Manor Bondholders only and the court was without jurisdiction to liquidate a debtor in a Chapter X proceeding when all other stockholders and creditors were to be eliminated.

The Hearing: The hearing on the petition and answer was commenced with a statement of counsel for the petitioning creditors that he had prepared a draft order that the petition was filed in good faith (Tr. 11). Witter's attorney urged that the statement that the Court "heard and considered the evidence" was untrue, and (Tr. 11-12) that the court had granted him the right to file an answer on the issue of "good faith" which he filed, and "there was no evidence adduced as to the good faith of the petition", and he asked that the record speak the truth. Counsel for the petitioning creditors

then stated (Tr. 12) that there was evidence prior to the appeal and that Witter's attorney had introduced a certified copy as an exhibit and that the petitioning creditors had introduced two exhibits which were all attached to the respective briefs which were filed with the Court. The Court stated (Tr. 14) that it considered the matter on the briefs and that it would approve the petition as filed in good faith, and if upon the hearing of the plan it developed there was no property to be reorganized then the plan would fail. Witter's counsel objected to such proceedings and made an offer of proof in support of the answer (Tr. 15-16). The court said it would not pass on the offer of proof but would leave the matter to the Special Master to whom it would refer the case on the plan (Tr. 17-18) and that the approval of the petition as filed in good faith would not affect the rights of the parties if it later developed on the merits that there was no feasible plan and that the property could not be reorganized, the good faith would be affected thereby.* Thereupon, the Court approved the petition as filed in good faith by its order of March 13, 1945, and appointed a trustee (Tr. 22), from which order Witter appealed on April 10, 1945.

The Master's Report: The Master in Chancery who heard the evidence on the Plan of Reorganization of the respondents during the pendency of the appeal, over the objection of Witter, found that after the filing of the involuntary petition by the respondents on July 8, 1943, and its dismissal on September 14, 1943 (Tr. 49) the State Court reacquired jurisdiction to complete the par-

* Bearing in mind the decisions that the issue of good faith could not be raised on appeal from the approval of the plan in the absence of an appeal from the approval of the petition, Witter was compelled to appeal from the order approving the petition, notwithstanding the fact that the Court said it would reconsider the matter upon the coming in of the Master's report on the plan.

tial foreclosure which was commenced two years earlier because (Tr. 50) no restraining order was ever issued by the Bankruptcy Court while the bankruptcy proceedings were pending, and after its dismissal no supersedeas was granted on the appeal. Petitioning creditors knew of the pendency of the foreclosure proceedings and did not take any steps to stay the foreclosure in the State Court, and that Court was never advised of the pendency of the appeal. Prior to June 16, 1944, when the opinion reversing the dismissal order was rendered (Tr. 50), Witter obtained title on February 6, 1944 (Tr. 52), and on October 27, 1944, Joseph Willens, who was not a party to the bankruptcy proceedings, became the owner and the Debtor was completely divested of its title to the property (Tr. 53). He also found that the value of the Debtor's property was $197,218.14 and that the debt on the bond issue and accrued interest exceeded it by a "substantial amount" and there was no feasible plan upon which the corporation could be reorganized. He recommended the vacation of the order approving the petition as filed in good faith and the dismissal of the proceedings (Tr. 56).

The Opinion: The Court of Appeals was presented with the Master's report for its consideration in connection with Witter's motion to postpone the argument on the appeal until the disposition on the merits on the Master's report (Tr. 44-57).* It took the matter under consideration and rendered its opinion sustaining the order below. It sustained the order on its misconception that certain exhibits were omitted from the record (Tr. 61) under "well known rules" that reviewing courts "must" as-

* In view of the fact that Witter prosecuted the appeal in order to preserve his right on the issue of good faith and he thereafter received a favorable report on the merits which would make the appeal moot if the Master's report were sustained, he properly moved to postpone the hearing on the appeal until the disposition of the case on the merits of the Master's report.

sume that the omitted exhibits were the evidence on which the order was entered. When it appeared from the petition for rehearing (Tr. 70) that the exhibits were not omitted, the reviewing court, after conceding its error, said (Tr. 95) that it examined the exhibits and that "they substantiate" its decision, and denied the rehearing.

The opinion conceded (Tr. 65) that the filing of the petition did not "automatically" stay the foreclosure, but because Witter was a party to the bankruptcy proceeding he should have anticipated that the dismissal order might be reversed on appeal. While it admitted (Tr. 62) that Witter's foreclosure "was not automatically checked and no restraining order was issued" it affirmed the order on the ground that Witter knew "that the bankruptcy was pending" when he "took title" and that this was (Tr. 63) "an attempted fraud upon the Court". The Court refused to modify its opinion in the face of the petition for rehearing and the Master's report which showed that when Witter took title on February 6, 1944, there was no pending bankruptcy proceeding, as the proceedings then stood dismissed.

Specification of Errors to Be Urged.

1. The Circuit Court of Appeals erred in holding that an involuntary petition for corporate reorganization was properly approved as filed in good faith when it appeared that the property of the debtor was worth less than the first mortgage indebtedness and that all stockholders and creditors were to be eliminated and there was a foreclosure proceeding pending in the State Court and in the absence of a showing that the proceedings were inadequate to grant the relief to the first mortgage bondholders.

2. The Circuit Court of Appeals erred when it held that under Chapter X, in the absence of a restraining order and of a supersedeas on an appeal from the dismissal of the reorganization proceedings, a prior foreclosure proceeding which vested title in the grantee and which extinguished the title of the debtor was void and in holding that the involuntary petition under Chapter X was properly approved as filed in good faith.

3. It was the duty of the Circuit Court of Appeals to postpone the hearing on the appeal pending the disposition of the Master's report who recommended the dismissal of the proceedings on the ground that the alleged unincorporated company was nonexistent, that its title was extinguished, and that a third party was the owner of the property who was not made a party to the bankruptcy proceedings. It abused its discretion when it denied the motion and proceeded to dispose of the case and affirmed the order below, when the order was entered with the understanding that the District Court would reconsider the approval of the petition upon the coming in of the Master's report.

ARGUMENT.

I.

The interest of the alleged unincorporated company was extinguished by the foreclosure which ripened into a deed prior to the approval of the petition as filed in good faith, and the affirmance of the order cannot be reconciled with fundamental law in bankruptcy.

Faced with a record which showed that the interest of the alleged "unincorporated company" was *completely extinguished* by a foreclosure proceeding which was completed *prior* to the approval of the petition as filed in good faith, the opinion, in its attempt to sustain the order, states (Tr. 62) that "the undisturbed custody and administration of the assets have been *lodged in the District Court ever since the filing of the petition* for reorganization long prior to the decree of the State Court". *This assertion has no support in the record, and is contrary to the record.* The District Court was ousted of custody and administration when its appointment of the trustee was reversed by the same Circuit Court of Appeals (134 F. (2) 839). It did *not regain possession,* custody, control or administration *prior* to the time when Witter obtained his title on February 6, 1944. It had *no control,* custody, and administration of the property at the date of the approval of the petition on March 13, 1945, but the possession, control and administration was *under the jurisdiction of the State Court* through its Receiver who was then in possession.

The partial foreclosure of Witter was filed November 29, 1941. A Receiver was appointed on December 1, 1941,

in that proceeding. Thereafter, a complete foreclosure was filed by Heitman Trust Company on December 29, 1941 (Tr. 48). The receivership in the partial foreclosure was extended to the complete foreclosure (Tr. 53). The District Court placed its trustee in possession on June 17, 1942,* thereafter and he was only in possession from that date until he was ousted on September 21, 1943, upon the reversal of the order of his appointment (134 F. (2) 839). Upon the dismissal of the proceedings in 1943 the Heitman Trust Company which foreclosed under the first mortgage, and which had the receivership of the partial foreclosure extended to the first mortgage foreclosure was placed in possession** and remained in possession from Sept. 21, 1943, until March 13, 1945, when the involuntary petition was approved, and a trustee appointed by the order appealed from. The District Court *did not disturb the possession* of the State Court prior to March 13, 1945, when it approved the petition as filed in good faith. *The State Court* and *not* the Federal Court *was in custody, control and administration of the property* from December 1, 1941 to June 17, 1942, and from September 21, 1943 to March 13, 1945, when the District Court approved the petition and appointed its trustee. **The whole foundation of the opinion is therefore without any support in the record.***** The basic error of the court was pointed out in the petition for rehearing (Tr. 77). Not only was it pointed out that the facts appeared in the Master's report which was presented to it but that these

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* See R. 8475, p. 55, 323 U. S. 757, Nos. 405-406.

** See same record p. 15.

*** In view of the fact that the District Court was only in possession for the short period commencing June 17, 1942 to September 21, 1943 and which possession was without jurisdiction (134 F. (2) 839) and that the State Court was in possession from December 1, 1941, except for the short period, and continued to be in possession at the date of the approval on March 13, 1945, the statement in the opinion as to the "undisturbed" possession of the District Court indicates a complete misconception of the facts.

facts appeared from its own records and the exhibits, which it stated were not in the record, were shown to it that they were in the record (Tr. 61). On rehearing, the Circuit Court of Appeals *conceded its error* that the exhibits were before it and stated that it examined the exhibits but that they substantiated fully its conclusions. How these exhibits sustained its statement was not revealed by the opinion. All of these exhibits are before this Court and the particular exhibit showing that the State Court was in the control, custody and administration of the property appears in the record filed in this Court (R. 8098, pp. 44-45, ¶ 12) which is the record where certiorari was denied (320 U. S. 211) from the decision of the same Circuit (134 F. (2) 839), and the record in case No. 8475 *supra*. The Circuit Court of Appeals should not have closed its eyes to its own records and to the Master's report which *specifically found that the State Court was in control* and administration of the property and *not* the Federal Court and its opinion should have spoken the truth (Tr. 52-53).

(a) In the absence of a restraining order during the pendency of the reorganization proceedings and of a supersedeas during the pendency of an appeal from the dismissal of the proceedings for want of jurisdiction, the State Court properly completed the foreclosure proceedings.

The opinion *concedes* (Tr. 62) that the partial foreclosure was pending and "was not automatically checked and no restraining order was issued". It sustained the order approving the petition on the ground that Witter "was an active participant in the reorganization" who opposed it and, therefore, "knew full well" what was transpiring in the Federal Court. Conceding this to be true, what was the effect of his knowledge? He knew

that on September 13, 1943, there was no restraining order to restrain his foreclosure and that on that day the proceedings stood as dismissed on the ground that the District Court was without jurisdiction to reorganize the alleged corporation. He knew that the District Court found (R. 63-64):

> "1. The question of jurisdiction herein involved is the same question as was involved in the proceeding entitled, Peer Manor Building Corporation, a corporation, Debtor, in the United States Circuit Court of Appeals, for the Seventh Circuit, Case No. 8098.
>
> "2. The evidence does not show that there is here an association, individuals, or corporation, as are required for parties against whom an involuntary petition may be filed under the Bankruptcy Act."

He knew that the District Court concluded (R. 64):

> "1. That the issues herein involved are *res judicata* by the judgment of the United States Circuit Court of Appeals, for the Seventh Circuit, entered in the aforesaid cause in that court, numbered 8098.
>
> "2. That this Court is without jurisdiction to entertain the aforesaid petition filed herein by G. J. Nikolas, *et al.*"

He also knew that it entered an order dismissing the proceedings (R. 65) and that an appeal was prosecuted but that *no supersedeas was granted.* With knowledge of these facts, and *prior* to the reversal of the dismissal order he "took title" to the property on February 6, 1944, after the alleged unincorporated company *failed to redeem* from the foreclosure sale.

The statement in the opinion (Tr. 63) that when Witter "took title" he *knew* that bankrupcy was *pending* runs *counter* to the record. He "took title" February 6, 1944, more than four months before the approval of

the petition as filed in good faith on March 13, 1945 (Tr. 52; ¶ 34); on the day when he took title *there was no pending* bankruptcy proceeding. These proceedings *stood dismissed* and the appeal, *without a supersedeas,* did not convert the *dismissal* proceedings into *pending* proceedings. In view of such a situation, it is impossible to understand the statement in the opinion (Tr. 63):

> "When appellant later procured partial title, he knew he was *impinging upon and attempting to defeat the jurisdiction* already vested in the bankruptcy court by virtue of the constitution and the Act of Congress. He was fully warned that he could not do this. His persistence was an idle, fruitless attempt to defeat the District Court's jurisdiction and, indeed, *an attempted fraud upon the Court.*" (Emphasis ours.)

How was Witter "impinging upon and attempting to defeat the jurisdiction already vested in the Bankruptcy Court", and how was his persistence to complete the foreclosure "an attempted fraud upon the Court"? The only order that was then in force was *the order* of the District Court itself *that it was without jurisdiction* of the bankruptcy proceedings. **How can the act of a party who proceeds with a State Court proceeding in reliance on the order of the District Court that it was without jurisdiction tend to defeat the jurisdiction and to defraud it?** This question was asked of the Circuit Court of Appeals in the petition for rehearing (Tr. 78). The Court replied (Tr. 95) that the petition for rehearing, except as to the reference to the exhibits, was "only reargument." The question was *unanswerable.*

(b) The court failed to notice the distinction between ordinary bankruptcy and proceedings under Chapter X and its decision is not only not in accord with the views of other circuits, but also with its own view in other cases.

The opinion relies (Tr. 63) on *May* v. *Henderson*, 268 U.S. 11, on the point that the "filing of the petition is a *caveat* to all the world". No one disputes that law but here the petition was *dismissed*, and Witter *knew* that it was dismissed for want of jurisdiction. The filing of the petition, therefore, was of no consequence*.

The opinion quotes from *Gross* v. *Irving Trust Co.*, 289 U. S. 342, that upon adjudication title vests in the trustee as of the date of the filing of the petition in bankruptcy, and it cites *Isaacs* v. *Hobbs*, 282 U. S. 734, on the point that jurisdiction of the Bankruptcy Court is exclusive and paramount. It failed to notice *its own decision* distinguishing these cases which apply to the *ordinary* bankruptcy and *not* to reorganization proceedings under Chapter X as distinguished in *the Matter of Ella Tinkoff*, 141 Fed. (2d) 731, where the same Circuit Court of Appeals said (p. 732):

> "**Since there was no effective stay order in force** prior to our order of March 6, 1936, **and since the Bankruptcy Act did not automatically stay such proceedings, we look to prior decisions to learn whether the appellants have any support for their contention that the filing of the petition in bankruptcy by its own force made void all proceedings in the State court.** They rely upon *Isaacs* v. *Hobbs*, 282 U. S. 734, 51 S. Ct. 270, 75 L. Ed. 645. In that case, the State foreclosure proceedings were begun **after** the

* If the filing of a petition is "a caveat to all the world", then the dismissal of the petition is equally a "caveat" to all the world. Not only was the dismissal constructive notice, but Witter who was a party to the proceedings knew that there was no bankruptcy proceeding pending.

bankruptcy proceedings had been instituted and after the bankruptcy trustee had thereby acquired constructive possession of the land. In the case at bar, the bankruptcy petition **followed** the commencement of the foreclosure proceedings in the State court.

The mortgages foreclosed in the State court were not vulnerable under the Bankruptcy Act. The State court was in possession of the property and was foreclosing valid mortgages when the petition in bankruptcy was filed. The filing of such petition in and of itself did not oust or affect the jurisdiction of the State court to proceed to final disposition." (Emphasis ours.)

This distinction applies with equal force here.

(c) The opinion failed to notice the distinction between a foreclosure completed in the absence of a supersedeas and the case where the appeal operated as a supersedeas as distinguished by this court in the cases which it cited.

The opinion says that *Wayne United Gas Co.* v. *Owens-Illinois Glass Co.,* 300 U. S. 131, is "strikingly pertinent." The opinion of this Court in *Union Joint Stock Land Bank of Detroit* v. *Byerly,* 310 U. S. 1 *distinguishing* the *Wayne* case was called to its attention in Petitioner's Reply Brief and is mentioned in its opinion. In distinguishing the *Wayne* case this Court pointed out that while the State Court's jurisdiction was superseded by the Bankruptcy Act, the jurisdiction of the State Court "again attached" upon *dismissal* of the bankruptcy case and it, therefore, had the right to proceed with the "foreclosure suit" and the State Court's procedure *"was as if no bankruptcy case had ever existed."* This Court also *distinguished* the *Wayne* case on the ground that there the appeal operated as a *supersedeas* while in the latter case *no supersedeas was granted.* The dissenting

opinion in the *Union Land Bank* case was based on the point that:

> "Paralleling the situation in the *Wayne* case, not only was the mortgagee-purchaser here a party to the 75 proceeding, but the State Court itself may be said to have acted with knowledge that the dismissal —of which it was notified—did not necessarily represent the last step in the Federal Court proceeding."

The majority of this Court was not persuaded by this argument. The fact that Witter was a party to the Chapter X proceedings did not affect the State Court proceedings*. Witter did not obtain his title under the order from which the appeal was taken as to have a binding effect on him even in the absence of a supersedeas, but *he acquired his title in an independent suit which was not restrained and after the dismissal of the bankruptcy proceedings,* which order was in effect when no supersedeas was obtained.

The *Wayne* case is also distinguishable on another ground. There, the proceeding was under Section 77B, and no restraining order could have been issued prior to the approval of the petition. When the court failed to approve the petition, *the Debtor was helpless.* If the petition was approved it would have either operated as a restraining order according to appellee's contention, or a restraining order would have been issued. It, therefore, prosecuted and obtained a *supersedeas.* This operated as *if the Debtor had obtained the approval and had obtained the restraining order.* When the creditors decided to complete the foreclosure *in the face of the supersedeas,* which the State Court granted with "full knowledge" of the fact, *they acted at their peril.* The reversal of the order

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* In the Union Bank case the "mortgagee-purchaser" was likewise a party. Here, the property was thereafter acquired by petitioner Willens, a complete stranger to the proceedings.

of dismissal with directions to approve the petition as filed in "good faith" operated as if the petition was approved *before the foreclosure was completed.*

Here, the respondents *could have applied and obtained a restraining order prior to the approval of the petition* under Section 113, and *they failed* to avail themselves of such right. The proceeding was dismissed and the appeal *did not operate as a supersedeas.* The State Court *had no knowledge of the facts.* The reversal on appeal did *not* direct the approval of this petition as filed in good faith and only involved the *jurisdictional* question and the plea of *res adjudicata.* The foreclosure was completed *before the approval* of the petition and when the petition was approved, *the title of the Debtor was completely destroyed.*

That it was not the intention of Congress to automatically put an end to pending state court foreclosure suits through the mere filing of a petition for reorganization is apparent from the decision in the case of *Marine Harbor Properties* v. *Mfg. Tr. Co.,* 317 U. S. 78.

A well reasoned case showing the application of the rule is that of *Hoehn* v. *McIntosh,* 110 Fed. (2d) 199. There, the trustee, in a Chapter X proceeding, secured an order for the sale of the real estate in which the debtor had an equity. A state foreclosure suit had been commenced before the petition was filed, but process had not been served upon the bankrupt. The action of the trustee in selling the real estate was *reversed.* In referring to the exclusive jurisdiction of a court of Bankruptcy and in holding *that it was not applicable under Chapter X to a pending foreclosure case,* the court said:

> *"However, this rule does not apply to the enforcement of liens not invalidated or voided by the Bankruptcy Act for the enforcement of foreclosure for*

> *which proceedings in the State Court have been instituted prior to the commencement of proceedings in Bankruptcy either* within or before the four month period where the State Court has first acquired actual or constructive possession of the property. *Straton* v. *New*, 283 U. S. 318; *Davis* v. *Friedlander*, 104 U. S. 570. *In order for the Bankruptcy court to draw to itself the administration of mortgage property as to which at the time of bankruptcy a foreclosure suit was pending, it is necessary for the trustee to establish* (1) *that the mortgaged property was in the possession of the bankrupt at the time of the filing of the petition and not in the possession of the State Court in which the foreclosure suit was pending*, and (2) *that there was an equity in the mortgaged property for the bankrupt estate.*" (Italics ours).*

The state court foreclosure proceeding begun by Witter had been pending **since** 1941. **The petition was filed in July 1943, and before its approval, a sale was held and a deed was issued.**

Since the mere filing of the petition under Chapter X did not operate as an automatic stay of the foreclosure suit, there was nothing left to reorganize and the approval of the petition as filed in good faith was improperly sustained.

In the instant case, *the appeal did not operate as a supersedeas.* The dismissal of the case *without a supersedeas* left the case *as if no bankruptcy proceedings was pending,* and the State Court was within its right to complete the foreclosure, the same as in the *Union Land Bank* case.

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* This case was cited with approval in Muffler v. Petticrew Real Estate Co., 132 F. (2) 479, 481, where the court reversed an order in bankruptcy which restrained a foreclosure commenced four months prior to the filing of the bankruptcy proceeding.

In the Petition for Rehearing, Witters quoted from the *Union* case (310 U. S. 1, 8) the following:

> "The case is analogous to one wherein a state court foreclosure proceeding has been completed and deed delivered to the sheriff's vendee prior to the filing of a petition under Section 75. The provision for the reinstatement, upon the debtor's motion, of a proceeding theretofore dismissed and finally terminated, *cannot affect the jurisdiction of the court conducting the foreclosure proceeding when no bankruptcy cause was pending.*" (Emphasis ours.)

The petition pointed out that in commenting on *Wayne* case on which the Court of Appeals relied, the court pointed out (p. 9) that in the *Wayne* case, after the dismissal of the proceedings and before proceeding with the foreclosure, notice was given of the appearance for a rehearing, and after granting the rehearing and the subsequent dismissal *"the debtor appealed * * * and was granted a supersedeas"*. There, the State Court had *"full notice of all of these facts"* and that the appeal *operated as a supersedeas,* and in spite of that, it proceeded with the foreclosure. This court said (p. 10):

> "We held that, *in the circumstances,* no rights were acquired under the state court proceedings since termination of the bankruptcy case did not occur until final disposition of the efforts in the District Court and on appeal to reverse the decree of dismissal."

This was more strikingly brought out by the Master in Chancery (Tr. 50, ¶ 17) that the respondent had knowledge of the pendency of the partial foreclosure and (¶ 18) that the Superior Court "was never informed and advised" of the pendency of the bankruptcy proceedings. The Master pointed out (Tr. 55, ¶ 5) that the provision in Chapter X for a "Stay order" prior to approval "clearly implies that in the event the debtor fails to avail itself of

such right, then it must abide the consequences of such failure or neglect". The Master stated that to hold otherwise "would be to reward or place a premium" for "failure or neglect" to assert a right. This argument is irresistible and the Court of Appeals clearly erred in completely ignoring his report.

II.

The decision in the instant case that on a contest at the outset on the good faith of the involuntary petition under Chapter X an order that it was filed in good faith was proper when it appeared that the property was valued less than the first mortgage bond issue and that there was nothing for creditors and stockholders, is in direct conflict with the decisions of the Second and Third Circuits and with the decisions of this Court.

The decision in the instant case runs counter to the decision of this court as interpreted by the Second, Third and Sixth as well as by the Seventh Circuit in an earlier case.

(a) The decision that a petition which alleged that the debtor's property should be liquidated for one class of secured creditors under Chapter X is filed in good faith when contested at the outset, is in conflict with the decision of this court as construed by other circuits.

The question whether under Chapter X involuntary proceedings to reorganize a corporation may be invoked by secured creditors when the property is valued less than the secured debt and creditors or stockholders are not to participate in the reorganization was decided by this Court in two decisions. *Marine Harbor Properties* v. *Mfs. Trust Co.*, 317 U. S. 78; *Fidelity Assurance Assn.*

v. *Sims,* 318 U. S. 608. There is a disagreement between the Third and Seventh Circuits as to the interpretation of these decisions, and there is no harmony in the decisions of the Seventh Circuit.

The question first arose in the Seventh Circuit in re: *Biltmore Grand Apartment Building Trust* (146 F. (2) 81), where in affirming the decision below (59 F. Supp. 1000) it did *not concede* that under the decisions of this Court an involuntary petition to reorganize a corporation when there were no assets above the first mortgage liability and nothing for creditors and stockholders was not filed in good faith.* It based its affirmance on a *different* ground. It arrived at the same conclusion in the instant case where it was conceded that *under no conceivable theory* was there anything available for creditore or stockholders and there was a pending foreclosure for the benefit of the first mortgage bond holders and no showing was made that the proper relief could not be afforded in the State Court. The opposite view was taken by the Third Circuit when it *adopted* the decision below (*re: St. Charles Hotel Co.,* 149 F. (2) 645) stating that the decision of the trial court (60 F. Supp. 322) was an *"excellent"* decision and it adopted that decision in lieu of its own. Certiorari was denied by this Court (66 S. Ct. 48). There, the District Court originally approved the petition under Chapter X as filed in good faith and upon a motion to show cause why the order should not be vacated on the ground that it was

* The same judge who wrote the opinion in the instant case on behalf of the Seventh Circuit overlooked his own opinion in Lorraine Castle Apartment Building Corporation, 149 F. (2) 55, where he construed the decision of this court on the point that where such a petition was contested at the outset and not after its approval, that it must be dismissed on appeal for want of good faith. Here, the contest was at the "outset" and the appeal was taken from the approval order.

unreasonable to expect that a Plan of Reorganization can be effected under the provisions of that Act, the Court vacated the order and dismissed the proceedings. It pointed out (p. 325) that Section 146 of Chapter X defined the term of "good faith" by showing that in a prior proceeding the interest of creditors and stockholders could not be best served except in the reorganization proceeding and it referred to the "most recent complete expression" of this Court in *Marine Harbor Properties* v. *Manufacturers' Trust Co.*, 317 U. S. 78, where the property sought to be reorganized was worth less than the first mortgage debt and this Court there held "that the debtor petitioning under Chaper X had not sustained the burden which was upon it to show that the interests of the creditors and stockholders would best be subserved in the Chapter X proceeding where there was a prior State foreclosure proceeding pending." The District Court pointed out that when the answer contesting the good faith of the petition was filed it became "the burden of such petitioner to demonstrate that his petition is filed in good faith." In disposing of the contention there made that it was proper to file a petition which sought to reorganize the property for the benefit of only *one* class, the secured creditors, and in holding adversely to that decision the Court said (p. 328):

> "It was contended in the *Marine Properties* case, as it is contended by the Securities and Exchange Commission in this case, that there are numerous safeguards contained in Chapter X that are lacking in the state court proceedings. In that case the Schackno Act of New York, N. Y. Laws 1933, c. 745, Unconsol. Laws N. Y. § 4871 *et seq.*, was involved, whereas we are concerned with proceedings authorized under the New Jersey law in insolvency, receivership and reorganization. Title 14, Chapter 14, Revised Statutes of New Jersey of 1937, N.J.S.A. 14:14.

We need not examine the differences between the two procedures, for the Supreme Court fully answers this contention as follows: 'Those considerations would be highly relevant and persuasive if this was a case of the usual reorganization proceeding dealing with more than one class of securities under the older procedures which Ch. X was designed to improve and supplant * * *. Then the safeguards afforded by Ch. X would have special significance in protecting the respective classes of investors against improvident, unfair or inequitable adjustments, compromises, and settlements—steps which are basic to the reorganization process but which in selfish hands led to much abuse.

The Court further said:

"In the language of the Supreme Court: 'In view of the burden on a petitioner to make the showing required by § 130 (7) and § 146 (4), the bankruptcy court is not warranted in assuming without more than a state foreclosure proceeding instituted for and on behalf of the first mortgage creditors exclusively is inadequate, measured by Ch. X standards, to protect their interests. The contrary course would result in Ch. X making greater inroads on prior proceedings than § 130(7) and § 146(4) indicate was the purpose.' *Marine Harbor Properties* v. *Manufacturer's Trust Co.*, 317 U. S. 78, at page 88, 63 S. Ct. 93, at page 98, 87 L. Ed. 64.

In fact, it appears from the record that if a plan of reorganization is effected it could consist of no more than an equivalent to a foreclosure of the rights of all creditors and stockholders other than the first mortgage bondholders. Whether the corporation be liquidated and the lienors paid off, whether foreclosure proceedings be taken and the property sold to the lienors, or whether the first mortgagees convert their bonds into stock as evidence of their ownership, the effect and net result would be the same—the first mortgage bondholders alone may partici-

pate in the proceedings and determine the ultimate form of their holdings."

It held that that petition was improperly approved as filed in good faith and vacated the previous order and cited (p. 329) *Fidelity Insurance Association* v. *Sims,* 318 U. S. 608. This decision which was adopted by the Third Circuit as its own decision is *diametrically opposed to the decision of the Seventh Circuit* in the instant case.

The decision of the Seventh Circuit in its interpretation of the decision of this Court in the *Fidelity* case is also in *conflict* with the views of the Second Circuit. (*In Re Loewer's Gambrinus Brewery Co.,* 141 F. (2) 747, where the court said (p. 749):

> "Our decision in *Frank* v. *Drinc-O-Matic,* 136 F. 2d 906, is authority for the order of sale appealed from unless the opinion of Justice Roberts in *Fidelity Assurance Ass'n* v. *Sims,* 318 U. S. 608, 63 S. Ct. 807, 87 L. Ed. 498, stands in the way. But that opinion would not seem to have any bearing on the situation here. It merely states that a *petition for reorganization where liquidation,* and not a readjustment of the rights of creditors, *was at the very outset* the only possibility, *should be dismissed,* as not filed in good faith. The petition was attacked at the outset on the ground that it was not filed in good faith and the Supreme Court held that to institute a proceeding under Chapter X in case where there was no chance of reorganiaztion was a violation of the statute. The Supreme Court said (318 U. S. at page 622, 63 S. Ct. at page 814):
>
> 'Congress did not intend a Chapter X case to be turned into a liquidation proceeding at the outset, but intended the litigation to become a straight bankruptcy only after the failure to consummate a plan, and meant to limit the parties to their remedy in ordinary bankruptcy in all other cases.' "

This was restated in *Country Life Apartments* v. *Buckley,* 145 F. (2) 935, where the Court said (p. 938):

> "Appellants also contend that the trustee's plan could not be confirmed in reorganization proceedings, because it was in reality not a plan of reorganization, but only a means of effecting the complete liquidation of the debtor's property, within the condemnation of *Fidelity Assurance Ass'n* v. *Sims,* 318 U. S. 608, 63 S. Ct. 807, 87 L. Ed. 1032. *That case, however, held merely that a petition is not filed in good faith where liquidation, and not a readjustment of the rights of creditors, was at the very outset the only outcome to be expected.* There the petition was attacked for lack of good faith in the initial stages of the proceedings, and the Court held that a proceeding could not be instituted under Chapter X where there was no chance of reorganization."

There views were repeated in *Patent Cereals* v. *Flynn,* 149 F. (2) 711, 713, where the Court said:

> "Finally, we cannot take the view of the District Judge that the opinion of Justice Roberts in *Fidelity Assurance Ass'n* v. *Sims,* 318 U. S. 608, 63 S. Ct. 807, 812, 87 L. Ed. 1032, required him to dismiss the reorganization proceeding under Chapter X and to proceed with the pending bankruptcy proceeding against the debtor. In *Fidelity Assurance Ass'n* v. *Sims, supra,* it was found that the petition for reorganization under Chapter X had not been filed in good faith because from the very outset it was apparent that no readjustment of the rights of creditors was possible and that 'the interests of creditors would be best subserved in the pending prior proceeding in West Virginia and other states.' See our opinions in *Re Loewer's Gambrinus Brewery Co.,* 2 Cir., 141 F. 2d 747, 749, and *Country Life Apartments* v. *Buckley,* 2 Cir., 145 F. 2d 935, 938, quoted as distinguishing *Fidelity Assurance Ass'n* v. *Sims* in *Matter of Lorraine Castle Apartments Bldg. Corp.,* 7 Cir., 149 F. 2d 55."

The case which it cited from the Seventh Circuit was written by the same judge who wrote the opinion in the instant case. He overlooked that here, it appeared "at the very outset" that *liquidation* and not *reorganization* would be "the only outcome."

(b) The lack of the jurisdictional allegations was fatal.

Not only were the petitioning creditors defeated by the *proof,* but their jurisdictional *allegations* were *fatally* defective. They alleged (R. 8; par. 15) that "the secured indebtedness must be liquidated". This came within the rule announced by the Sixth Circuit in *Hoehn* v. *McIntosh,* 110 F. (2) 199, calling for a dismissal of the case, where the court said:

> "Conceding without deciding, that the present suit in the State of Ohio, because of a lack of process, had not reached the state of a proceeding *in rem* and that the constructive possession of the *res* does not vest until service of process, we think it nevertheless necessary, in order to oust the Ohio court of jurisdiction that the trustee show there was an equity in the mortgaged property for the bankrupt estate, otherwise it has no interest to subserve in ousting the State Court of jurisdiction. We think the record in this case fails to show such equity. *Ford* v. *Mutual Benefit Life Ins. Co.,* 82 Fed. (2d) 607; In *re Rohrer,* 177 Fed. 218; *Hiscock* v. *Varick Bank,* 206 U. S. 28."

This view was also adopted by the Seventh Circuit in *Sheridan View Bldg. Corp.,* 149 F. (2) 532 where it said:

> "The petition must set forth the essential fact constituting the right to proceed in bankruptcy when a prior proceeding is pending the petitioners showing of 'need for relief' must demonstrate that at least in some substantial particular the prior proceedings withhold or deny creditors' or stockholders'

benefits, advantages or protection which chapter X affords."

The attempt to distinguish this case (Tr. 61) on the "facts" was *futile* in view of the fact that it held that failure to *plead* jurisdictional fact was *fatal* in that case.

Failure to *plead* jurisdictional facts on questions whether the corporation can be reorganized for the benefit of creditors and stockholders was held fatal by the Sixth Circuit in *Re: Western Tool and Mfg. Co.*, 142 F. (2) 404 (reversed on a different point 324 U. S. 100). There the Court said (p. 410):

> "The purposes of liquidation (Chapter X) were (1) to avoid immediate liquidation of the property involved in the reorganization of a corporation *with a view to rehabilitating rather than liquidation*, (2) to afford a respite to corporations in financial difficulties so the owners and creditors might have time to recapitalize or refinance *and to preserve for all parties concerned intangible values which are usually a part of the assets of all going businesses and inseparable from its tangibles.*" (Emphasis supplied.)

This case was cited with approval on this point by the Seventh Circuit in *Sheridan View Bldg. Corp., supra.* To the same effect is the case of *In re* 325 *East* 72*nd Street*, 53 Fed. Sup. 997, 1001.

(c) The petitioning creditors did not meet the burden of proof to sustain jurisdictional requirements for an involuntary petition.

It is unnecessary to discuss whether the allegations contained all of the jurisdictional requirements under Chapter X. It is sufficient to show that there was an entire lack of proof to sustain the jurisdictional require-

ments even in the absence of the Master's findings that the proof showed that the jurisdictional requirements did not exist. The petitioning creditors were required to prove in addition to the allegations under Section 130 concerning voluntary petitions, *the jurisdictional allegations under Sections* 131 and 146. There was no evidence on the part of the petitioning creditors showing the essential facts required by Chapter X, that the prior proceeding pending in the State Court was insufficient to grant the relief to the first mortgage bondholders, nor was there any proof tending to show the "need for relief". That this was jurisdictional was held in *Sheridan View Bldg. Corp.*, 149 Fed. (2) 532, which the Seventh Circuit attempted to distinguish on a different point but is not distinguishable on this point. No evidence was offered in support of the petition except that the petitioning creditors attached to their brief the record on the previous appeal in Case No. 8472 (Tr. 12) as Petitioners' Exhibit 1. Witter's counsel *objected* to the procedure on the ground that it was necessary for the petitioning creditors to sustain the jurisdictional allegations by proof. There is nothing in Petitioners' Exhibit 1 tending to sustain the jurisdictional requirements under Chapter X.

This Exhibit was made a part of this record (Tr. 13) and by stipulation of the parties it was omitted from the printed record because it was printed in Case No. 8472 (Tr. 39). It was on the basis of the omission of this exhibit from the printed record that the Circuit Court of Appeals first held that the exhibit was not before it and it had to assume that the exhibit sustained the order on the jurisdictional requirements (Tr. 61). On rehearing the Court *conceded its error* (Tr. 95) but stated that it had examined the exhibit together with other exhibits referred to (the record in Case No. 8098) and that these

exhibits substantiate the approval of the order. What is there in these exhibits that prove the jurisdictional requirements? These exhibits were fully discussed in the petition for rehearing (Tr. 4-8). It was demonstrated there that the jurisdictional requirements were not sustained by the exhibits. The Court of Appeals satisfied itself with the bare assertion that the exhibits substantiated its conclusions. These exhibits are before this Court. The record in Case 8472 is here (323 U. S. 757 No. 404). The record in Case 8098 is also here (320 U. S. 211). We ask this Court to look at the exhibits in connection with their discussion in the petition for rehearing (Tr. 4-8). It could come to no other conclusion that *none of the jurisdictional requirements were proven by these exhibits.*

A hearing on a contest on the "good faith" by an answer is not to be perfunctory. The petitioners had the *burden to prove* the jurisdictional facts (*Duggan* v. *Sansberry,* 90 L. Ed. 622, March 4, 1946). There this Court pointed out that under Chapter X even where a Court approved *ex parte* the petition as filed in good faith it had no effect upon the subsequent answer contesting the good faith of the petition, and that the proper construction of the provisions of Chapter X lead to the conclusion that the approval of a petition prior to the contest is to have no weight and that upon the filing of the petition the burden rests upon the petitioning creditors to prove the allegations with proper evidence. This Court pointed out that on the order of approval under Section 141 which consists "first" of a conclusion of law to the effect that the petition is sufficient in respect of its allegations and "second" of a finding of fact that the petition is filed in good faith operates as not to make the *ex parte* determination conclusive and that the hearing on the contest con-

stitutes a second hearing upon which the burden rests upon the petitioning creditors to sustain the jurisdictional allegations by competent proof. In that case this Court said:

> Thus, under §§ 137 and 144, an answer could be filed to National's petition, denying that National was a subsidiary of Christopher, and asking that the petition be dismissed. The judge would then be obliged to hold at least a summary hearing, see *Re Cheney Bros.* (D. C.) 12 F. Supp. 609, 611, 30 Am. Bank. Rep. (N. S.) 741, a material allegation being controverted, and to decide the disputed issue on its merits.
>
> In as much as the interested parties thus had an opportunity in the reorganization proceeding to dispute the allegation of National's petition that a parent-subsidiary relationship existed between it and Christopher and by doing so to have that issue determined on the facts, we think it plain that Congress intended that the same issue could not be tried collaterally in the bankruptcy proceeding."

In the instant case *no opportunity* was given to try the facts as to the "good faith" and when Witter's attorney made an "offer" of proof (Tr. 15-17), the Court said: "If that is competent, I am *not* going to pass on it. You may present that to the Master." The Court then approved the petition as filed in good faith and the respondents proceeded before the Master who rendered his report recommending the *vacation* of the order approving the petition as filed in good faith, which the Circuit Court of Appeals entirely ignored. It is evident that not only was the burden of proof not met, but *the proof did not sustain the allegations* and it was the duty of the Circuit Court of Appeals to reverse the order and to direct the dismissal of the proceedings.

III.

The jurisdiction under Chapter X in the absence of a restraining order and a supersedeas on appeal attached from the date of the approval of the petition and not from the filing date.

The holding in this case that the jurisdiction of the Federal Court upon the approval of the petition on March 13, 1945, antedated from the filing date, July 8, 1943, and that this operated as an attachment on the foreclosure proceedings is based on a misconception and a failure to distinguish between proceedings under Chapter X and proceedings in ordinary bankruptcy.

It is true as stated in the opinion (Tr. 62) that Sections 102, 111, 112, 114 and 115 of Chapter X provide that the jurisdiction under that Chapter is the same as the jurisdiction in bankruptcy. The Court, however, overlooked that each of these provisions contain the words "where not inconsistent with the provisions of the Act" and that the provisions in Chapter X for a temporary restraining order is inconsistent with the provisions in ordinary bankruptcy. Section 113 of Chapter X (111 U. S. C. A. 513) provides for a temporary stay of foreclosure *prior* to the approval of the petition. The provision for the *temporary stay* clearly shows the intent of Congress that the approval of the petition shall not affect pending foreclosures *unless a temporary restraining order was issued.* The further provision in Section 148 (11 U. S. C. A. 548) that the *approval* of the petition "shall operate as a stay of a prior * * * mortgage foreclosure" *runs counter* to the holding that a subsequent approval antedates as of the filing date.

These views find support in *Long Island Properties, Inc.,* 42 F. Supp. 323, where the court said (p. 324):

> "Prior to the enactment of the Chandler Act, it was well established that the mere filing of a petition in Bankruptcy or reorganization did not interfere with the power of a State Court to continue a pending foreclosure."

The court cited *Murel Holding Corp.*, 75 F. (2) 941, and *Coney Island Hotel Corp.* v. *Van Schack,* 76 F. (2) 126, involving proceedings under Section 77B. In holding that not only did Chapter X *not change the rule,* but rather *"confirmed that rule",* it said:

> "There is nothing in the Chandler Act which expressly modifies that rule; to the contrary, **there is implicit in the carefully designed scheme of that Act a legislative intent to confirm that rule.** Thus by Section 113, 11 U. S. C. A. 513, prior to the approval of the petition, a temporary stay of a mortgage foreclosure may be had only upon cause shown, effective until the petition is approved or dismissed. By section 116 (4), 11 U. S. C. A. 516 (4), upon the approval of the petition a proceeding to enforce a lien against the debtors may be stayed until final decree. By Section 148, 11 U. S. C. A. 548, the order approving the petition operates as a stay of a mortgage foreclosure proceeding.
>
> In the presence of these provisions of the statute **it is impossible to stretch** the meaning of Section 111, 11 U. S. C. A. 511, **to embrace an automatic stay** of a mortgage foreclosure immediately upon filing of the petition.
>
> **It follows that the mere filing of a petition for reorganization on July 3, 1941, did not deprive the state court of its power to proceed with the foreclosure.** On July 15, two days before the foreclosure judgment was entered, the power to stay conferred by Section 113, was exercised." (Emphasis ours.)

These views were adopted by the Second Circuit in *Country Life Apts. v. Buckley,* 145 F. (2) 938, *supra.*

It might be added that only because Section 111 of the Bankruptcy Act gives the bankruptcy court exclusive jurisdiction of the debtor or its property, does the bankruptcy court have the **power** to restrain pending state court proceedings. Otherwise, the state court, once having assumed jurisdiction of the debtor's property, could not be ousted from its jurisdiction. However, the Bankruptcy Court must affirmatively exercise its power to deprive a state court of its jurisdiction, once exercised.

All of the cases cited in the opinion as purporting to establish a contrary rule are not in point, because in those cases, the state courts first attempted to assert jurisdiction *after* the petition in bankruptcy was filed and the proceedings were not under Chapter X. The case of *Isaacs* v. *Hobbs Tie & Timber Co.,* on which the court relies, is analyzed and distinguished by the same Court *In the Matter of Ella Tinkoff,* 141 Fed. (2d) 731. There, the court said (p. 732):

> "**The mortgages foreclosed in the State court were not vulnerable under the Bankruptcy Act. The State court was in possession of the property and was foreclosing valid mortgages when the petition in bankruptcy was filed. The filing of such petition in and of itself did not oust or affect the jurisdiction of the State court to proceed to final disposition.** The rule in such circumstances is stated thus in *Straton* v. *New,* 238 U. S. 318, 326, 51 S. Ct. 465, 75 L. Ed. 1060:
>
> 'Following these cases the federal courts have with practical unanimity held that where a judgment which constitutes a lien on the debtor's real estate is recovered more than four months prior to the filing of the petition, the bankruptcy court is without jurisdiction to enjoin the prosecution of the creditor's action, instituted prior to the filing of a petition in bankruptcy, to bring about a judicial sale of the real estate.
>
> "The trustee in bankruptcy may intervene in such suits to protect the interests of the estate.'

"The rule enunciated by Justice Miller in the old case of *Eyster* v. *Gaff*, 91 U. S. 521, 524, 23 L. Ed. 403, is applicable to the facts of our case and effectively disposes of the appellants' argument. Justice Miller said:

'It is a mistake to suppose that the Bankrupt Law avoids of its own force all judicial proceedings in the State or other courts the instant one of the parties is adjudged a bankrupt. There is nothing in the act which sanctions such a proposition.

'The court in the case before us had acquired jurisdiction of the parties and of the subject-matter of the suit. It was competent to administer full justice, and was proceeding, according to the law which governed such a suit, to do so. It could not take judicial notice of the proceedings in bankruptcy in another court, however seriously they might have affected the rights of parties to the suit already pending.

'It was the **duty** of that court to proceed to a decree as between the parties before it, until by some proper pleadings in the case it was informed of the changed relations of any of those parties to the subject-matter of the suit. Having such jurisdiction, and performing its duty as the case stood in that court, we are at a loss to see how its decree can be treated as void. • • • '

The proceedings in the State court were valid. Ella Tinkoff is not shown to have any interest in the property for which she seeks to provide an arrangement. There was no error in dismissing her petition." (Emphasis supplied.)

The attempt to distinguish its own decision (Tr. 64) on the ground that the case rested on different facts, is obviously unsound because whatever the facts might have been they could not have affected the jurisdictional requirements of the *pleadings*. In that case the court did not only hold that the jurisdictional requirements had

to be proven, but also that they *had to be alleged.* The case is, therefore, not distinguishable from the instant case.

CONCLUSION.

Petitioners have shown that the decision in the instant case is not in harmony with the decisions of the several Circuit Courts of Appeal and with the view of this Court as interpreted by the several Circuits. The involuntary petition was fatally defective in its jurisdictional allegations, and there was a complete failure of proof to meet the burden of good faith which was cast on the petitioning creditors upon the contest on such issue. There was no hearing before the Court as contemplated by the Act. The Master in Chancery rendered his report on the merits that the debtor was divested of all interest in the property prior to the approval of the petition as filed in good faith and that the title was in a stranger to the proceedings who acquired it in a foreclosure which was not stayed by the Bankruptcy Court and that no supersedeas was issued on the appeal from the dismissal of the bankruptcy proceedings. He found that the purpose of the proceeding was a liquidation at the outset and not a reorganization and that such a proceeding could not be invoked under Chapter X. He recommended the vacation of the order approving the petition as filed in good faith and the dismissal of the petition. In view of the fact that the court did not pass on the offer approved in entering its order approving the petition as filed in good faith but reserved that question for the determination by the Master in Chancery and in view of the further

fact that the Master sustained Witter and recommended the dismissal of the petition for lack of good faith, the appeal became moot upon the sustaining of the Master's report by the District Court and it was the duty of the Circuit Court of Appeals to grant the motion to postpone the hearing on the appeal pending the disposition of the hearing on the Master's report. The opinion in the instant case is not in harmony with the fundamental law in reorganization proceedings under Chapter X and is clearly erroneous. The writ should be issued to harmonize the decisions on an important question of federal administration.

Respectfully submitted,

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